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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

Same
Caption

No. 75

AMERICAN HARDWARE AND EQUIPMENT COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOSEPH J. O'CONNELL, JR.,
Counsel for Petitioner.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, American Hardware and Equipment Company, prays that a writ of certiorari be issued to review the decision of the United States Court of Appeals for the Fourth Circuit in the above case.

Opinions Below

The opinion of the Tax Court of the United States (R. 22-24)[1] is reported in Par. 52,197 P-H T.C. Memo. The opinion of the United States Court of Appeals for the Fourth Circuit (R. 72-79) is reported in—F. 2d—(1953) P-H Par. 72,349.

[1] "R." designates the Transcript of Record from the Court below.

Jurisdiction

The judgment of the United States Court of Appeals was entered on February 17, 1953 (R. 79). The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1), 62 Stat. 928.

Question Presented

During the taxable years ending July 31, 1947, and 1948, the petitioner was engaged in the wholesale hardware business in the states of North Carolina and South Carolina. During such years it made contributions to the National Tax Equality Association (hereinafter called "NTEA"), a non-profit organization, in the amounts of $1,800.00 and $1,500.00 respectively, to obtain assistance in meeting the competition of cooperatives engaged in the same business. The question presented is:

Whether the courts below erred in holding that these contributions were not deductible under Section 23(a)(1)(A) because of the Tax Court's finding that NTEA's objectives were the carrying on of propaganda activities or otherwise attempting to influence legislation.

Statute Involved

The statute involved is section 23(a)(1) of the Internal Revenue Code.

> "Sec. 23. DEDUCTIONS FROM GROSS INCOME.
>
> "In computing net income there shall be allowed as deductions:
>
> "(a) Expenses.
>
> "(1) Trade or business expenses.
>
> "(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.
>
> "(B) Corporate charitable contributions. No deduction shall be allowable under subparagraph

(A) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained * * *."

Statement of Facts

Reference to the Record discloses the following facts:

The taxpayer is a North Carolina corporation, engaged in the sale of hardware at wholesale in North and South Carolina. From the years 1934 and 1935, competition in this field became increasingly keen by reason of the growth of co-operative business organizations operating in its territory in a tax-free position, enabling such co-operatives to infringe upon the then-existing business of the taxpayer and to take over an increasing amount of the new business in the territory (R. 3). The competitive position of the co-operatives was strengthened by their tax-free status and enabled them to sell at a lower price and to offer certain "advantages" to the ultimate consumers, many of whom purchased through the co-operatives for the purpose of obtaining rebates or dividends made possible by the lower tax burden carried by the taxpayer's competitors. The taxpayer found itself in a competitive fight, not only to obtain new business, but even to maintain its then-position against odds which it felt to be discriminatory and unfair (R. 3).

It became necessary, in the opinion of the taxpayer's Board of Directors, to obtain information relating to the growth, mode and scope of operations, sources of supply, existing and contemplated outlets, financial structure, tax advantages and other data relating to this new type of competition (R. 6). Taxpayer's Directors considered the question of obtaining this necessary information at the lowest cost and determined to subscribe to the services of a business league known as the National Tax Equality Association, Inc. (R. 6).

The NTEA was organized in the State of Illinois as a non-profit organization and was ruled exempt by the U. S. Treasury Department under Section 101(6) of the Code as a scientific and educational association. By request of NTEA, this ruling was modified to exempt the association under Section 101(7) of the Code as a business league (R. 23). The purposes of NTEA as set out in its constitution and by-laws provided that the object of the corporation was to "conduct educational, scientific and research activities relative to disparities in Federal and State Tax Statutes and other laws and regulations affecting business and to disseminate such information to civic organizations and representatives of business affected thereby, to the public and to Federal and State Governments" (R. 5).

The taxpayer in the tax year 1947 made a contribution in the amount of $1,800.00, and in the tax year 1948 a contribution in the amount of $1,500.00 to NTEA for the purpose of obtaining the desired studies, data, and other information furnished by the NTEA and for the purpose of advising its clientele, incorporating the material into letters to its trade (R. 6), briefing its salesmen on the type of competition offered by the co-operatives and methods of combatting it (R. 6), and otherwise developing a sympathetic public opinion incident to maintaining and increasing its sales in competition with the co-operatives.

The taxpayer determined that it could obtain the necessary data through NTEA at less expense to itself than by maintaining its own research and tax staff (R. 9).

The petitioner benefited in developing a better relationship with its customers and with the ultimate consumer by utilizing the pamphlets and books obtained from NTEA (R. 8). The petitioner used the material furnished to carry its competitive story to the merchants from whom it purchased, to its wholesale accounts, and to the consumers, appealing to them and to the general pub-

lic to adopt a sympathetic attitude toward its problems in competition with the tax-free co-operatives and attempting to hold its customers and build its business goodwill (R. 8). The studies and pamphlets furnished the taxpayer by NTEA during the tax years in question made no mention of any objective of influencing legislation, nor did the NTEA call for members to write Congressman or intervene in pending legislative matters (R. 7).

Neither NTEA nor the taxpayer had a lobby in Washington nor did either attempt to approach Senators or Congressman to bring up any issue relating to changes in the tax laws (R. 10). NTEA merely sought to have its members work together to carry out its purposes as expressed in its Constitution and By-laws. The petitioner transposed information from pamphlets and books furnished by NTEA and forwarded such information to its customers (R. 11).

The taxpayer was not acquainted with the internal affairs of the NTEA, but was of the opinion that it operated from its Chicago headquarters rather than from any state organization in North Carolina or elsewhere. The taxpayer did not know the source of the material furnished it by NTEA and was not familiar with the identity of the individual research men or writers of such material.

From the time the petitioner became a member of the NTEA, it received bulletins and pamphlets in large numbers, which were of assistance in creating an atmosphere of goodwill within its trade territory and which were used for the purpose of appealing to the sense of fair play of the public and of its customers, present and potential, in order to increase its sales and profits (R. 6).

The Farmers Co-Operative Exchange, a co-operative operating in North Carolina, is in direct competition with the taxpayer (R. 17). It has had a phenomenal growth amounting to three or four times the growth experienced by the average corporation in the same field during the

same period (R. 17). The dollar volume of the purchasing co-operatives as shown by a report of the North Carolina Department of Tax Research directed to the General Assembly of North Carolina, indicated a growth within the nation from $190,000.00 in 1929-30 to $1,111,000.00 in 1946-47, or almost six thousand times (R. 18). The general business position of Farmers Co-Operatives Exchange had grown increasingly competitive and was particularly competitive in 1947 and 1948. The method used by the Farmers Co-Operative Exchange was to take over an existing business (R. 19). The rate of expansion of the Farmers Co-Operative Exchange in North Carolina was in excess of the rate of expansion by the ordinary merchant because of accumulated funds through profits derived from tax exemptions (R. 20).

Specification of Errors to be Urged

The Court of Appeals for the Fourth Circuit erred:

1. In holding that the petitioner's contributions were not deductible under Section 23(a)(1)(A) because of the Tax Court's finding that NTEA's objectives were the carrying on of propaganda or of otherwise attempting to influence legislation.

2. In affirming the decision of the Tax Court.

Reasons for Granting the Writ

I. In Denying the Deductions of Payments to the NTEA, the Decision of the Court of Appeals is in Conflict with Decisions of this Court and Decisions of other Courts of Appeal

Section 23(a)(1)(A) of the Internal Revenue Code provides that a taxpayer may deduct all "the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business". The Court

of Appeals did not question that the petitioner was engaged in a trade or business, or that its payments to NTEA were incurred in carrying on a trade or business. Nor did the Court deny that, in the usual sense of the terms, the payments were "ordinary" and "necessary" expenses in the conduct of the petitioner's business. *Cf. Welch* v. *Helvering*, 290 U. S. 111; *Deputy* v. *Dupont*, 308 U. S. 488; *Commissioner* v. *Heininger*, 320 U. S. 467; *Lilly* v. *Commissioner*, 343 U. S. 90.

The Court of Appeals, relying on the decision of this Court in *Textile Mills Corp.* v. *Commissioner*, 314 U. S. 326, disallowed the deduction for payments made by the petitioner because, simply, the payments were "expended for lobbying purposes * * * or the exploitation of propaganda". In reaching its conclusion, the Court of Appeals quoted from the *Textile Mills* opinion in part as follows:

> "Contracts to spread such insidious influences through legislative halls have long been condemned" (314 U. S. 326, at p. 338).

Furthermore, the Court of Appeals pointed out that in the *Textile Mills* case the Supreme Court had specifically approved a regulation (Article 262 of Treasury Regulation 74) denying deductions for lobbying expenditures. Although the injunction against lobbying contained in the old regulation in the *Textile Mills* case has disappeared[2] from the current regulations under section 23(a)(1), it may be argued that the underlying rationale of the old regulation still persists in the law. Expenses for "insidious" activities, "condemned" by this Court as activi-

[2] See Point II of this discussion, pp. 14-21, *infra*. In the years involved in this proceeding, the regulation approved in the *Textile Mills* decision had been revised and was no longer applicable to section 23(a)(1). Therefore to the extent that the decision of the Court of Appeals rests upon an approved regulation, it has no foundation whatever. Nor does any provision of section 23(a)(1)(A) itself so much as hint at the denial of a deduction for lobbying expenditures. *Cf.* section 23(q)(2).

ties "to which the law gives no sanction", remain unacceptable as deductible items. 314 U. S. 326, at pp. 338-339. But that is merely to say that such expenditures violate the firmly established public policy which was the basis of the old regulation. This Court, which recently rejected the government's assertion of an unbridled public policy doctrine, continues to recognize that expenditures inimical to "sharply defined national or state policies" are not deductible. *Lilly* v. *Commissioner*, 343 U. S. 90, 97. See also *Commissioner* v. *Heininger*, 320 U. S. 467, 474.

Do all lobbying activities *per se*, or the uses of "propaganda" in any form, violate "sharply defined" public policies? If not—and this Court made no such holding in *Textile Mills*—then the Court of Appeals' decision below has no foundation whatever. The decision becomes simply one more instance in which the Court of Appeals would act as an arbiter of public morals and acceptable business conduct. The activities of the NTEA which were ascertained by the Court of Appeals were clearly not of the same kind as those condemned in the *Textile Mills* decision. The decision below, therefore, would improperly ignore the standard enunciated by this Court in *Lilly* v. *Commissioner, supra.*

What were the activities of the petitioner and the NTEA which outraged the Court of Appeals, and to which the language of the *Textile Mills* opinion—"insidious" and "condemned"—may be applied? The sparse findings of fact by the Tax Court indicate that the expenditures of the petitioner were not made as part of a contract to secure special legislation; that the NTEA received no compensation, contingent or otherwise, for its legislative services; that the activities of the NTEA were principally research and the public dissemination of information relative to disparities in the federal and state taxing statutes, with the ultimate objective of revising the federal tax structure.

These findings may fairly be amplified by the following findings of the Tax Court in *Roberts Dairy,* Par. 50,271 P-H Memo T.C., which the Tax Court and the Court of Appeals deemed controlling in the instant case:

> "NTEA did not engage directly in lobbying activities, had no congressmen on its mailing list and did not request to appear before congressional committees considering changes in the tax statutes. Officials of NTEA did, however, appear before the Ways and Means Committee of the House of Representatives in 1947 at the Committee's request. In March 1946, NTEA, in one of its bulletins, asserted that the inquiry by this Committee concerning tax-exempt businesses was a direct result of the energy given that issue by NTEA.
>
> "In an NTEA publication dated February 1, 1944, the program of NTEA was to be one of dissemination to its members as well as to trade papers, periodicals, and newspapers of information prepared by its research division dealing with unequal taxation. It would also sponsor programs by speakers representing NTEA. It proposed to maintain a Washington counselor to represent the association and its members before congressional committees and other governmental agencies, as well as before state legislatures and other state, county and municipal bodies wherever tax problems arose.
>
> • • •
>
> "On November 19, 1943, a bill was introduced in the House of Representatives which on February 25, 1944, was enacted as the Revenue Act of 1943. Section 117 of the Act required organizations exempt from tax to file information returns. Publicity of NTEA gave credit to NTEA for the inclusion of this section in the bill as a result of NTEA's fact finding and publicity having been successfully presented by its members to Congress."

The legislative activities of the NTEA were not carried on in private chambers and cloakrooms. These activities were not calculated to, and did not, corrupt the political institutions of the nation. They bore no resemblance to the field of activity discussed in *Textile Mills* and condemned at common law.

The NTEA is an association of people with similar views on taxation. It has worked to have these views accepted by the public generally and, through the weight of public opinion, recognized by the public's representatives in the legislature. The petitioner urges that this type of activity, far from undermining stated public policy, conforms to recognized and indeed essential practices under our form of government.

As the Court of Appeals for the District of Columbia has recently stated, in *Rumely* v. *United States,* 197 F. (2d) 166, at p. 175:

> "Congress has a *duty* to protect the free flow from the people of influence, encouragement, promotion and retardation of legislative matters. So Congress has the right to restrict lobbying as properly defined, since such lobbying may, unless controlled, impede the effectual exercise of the people's power. *But Congress has no authority to impede the exercise of these functions of and by the people.*" (Italics added.)

The *Rumely* decision was affirmed by the Supreme Court without dissent. 73 Sup. Ct. 543. Justices Douglas and Black, concurring, indicated that restraints or controls over the defendant's right to publicize the legislative views of his organization would violate the First Amendment to the Constitution.

The kind of authority which Congress lacks certainly cannot be appropriated indirectly by the respondent. And it would be difficult to imagine a more direct impediment to legitimate legislative or lobbying activity than a disallowance of expenditures for such activity incurred in the

course of a taxpayer's trade or business. As the concurring opinion in the *Rumely* case observed, "* * * no legal sanction is involved here. Congress has imposed no tax, established no board of censors, instituted no licensing system". 73 Sup. Ct. 543, at p. 551.

Other courts have considered the matter whether all lobbying necessarily violates public policy, and answered in a clear negative. Some of these decisions, prior to the decision of the Supreme Court in *Lilly* v. *Commissioner*, were rendered at a time when no limit to the public policy doctrine was recognized.

In *Lucas* v. *Wofford*, 49 F. (2) 1027 (5th Cir.), fees paid to an attorney in connection with legislation that affected the taxpayer's business were allowed as a deduction. The Court stated:

> "The attorney was employed not to secure the passage or defeat of any legislation, but represent, by argument in a public and legitimate manner, to the Governor and to the legislative committees the injurious effect the legislation first proposed would have upon the respondent's business. Neither what was agreed to be done nor what was certainly done constituted lobbying" (p. 1028).

In *Leubuscher* v. *Commissioner*, 54 F. (2d) 998, the Court of Appeals for the Second Circuit allowed an estate tax deduction for a bequest to an educational foundation whose sole purpose was to teach, expound, and propagate the form of taxation known as the single tax on land advocated by Henry George. Since the single tax could only be achieved by legislation, it was clear that the educational foundation sought a change in legislation as its ultimate objective.

In *Los Angeles and Salt Lake R. R.*, 18 B.T.A. 168, the Board of Tax Appeals allowed the deduction of a contribution to the Association of Railroad Executives, which was engaged in an extensive advertising and publicity

campaign to avert enactment of legislation unfavorable to railroads. The Board stated:

> "It is clear that the purpose of the advertising and publicity campaign conducted by the Association was to create a body of public opinion favorable to the railroads of the country, and to avert the enactment of legislation unfavorable or injurious to them. The campaign was made by carrying in the newspapers of the country a series of advertisements setting forth the services rendered by the railroads, the problems confronting them, and suggesting sound legislation and wise regulation" (p. 177).

See, to the same effect, *International-Great Northern Railroad Co.*, 24 B. T. A. 726, 739; *Missouri Pacific Railroad Co.*, 22 B. T. A. 267, 287; *Kansas City Southern Ry. Co.*, 22 B. T. A. 949, 963; *Texas and P. Ry. Co.* v. *U. S.*, 52 F. (2d) 1040 (Ct. Cls.).

Subsequent to the *Textile Mills* decision, the Tax Court in at least two instances continued to recognize that not all legislative or lobbying activity was evil. In *Addressograph-Multigraph Corp.*, Par. 45,058 P-H Memo T. C., the court upheld a contribution to the National Association of Manufacturers, an organization engaged in "expressions of attitude with respect to legislation or other public policies". On the authority of *Los Angeles and Salt Lake R. R. Co., supra,* the Tax Court stated that contributions to correct unsympathetic public opinion are ordinary and necessary business expenses. See also *Robert S. LeSage,* Par. 47,318 P-H Memo T. C.

Now just what are the "family of contracts to which the law gives no sanction" which was the area of justifiable application of the old regulation? There is a line of decisions cited in the *Textile Mills* case and in other cases decided before and after *Textile Mills,* which does find an "insidious" character to certain forms of lobbying. See *Marshall* v. *B. & O. R. R. Co.*, 16 How. 314; *Trist* v. *Child,*

21 Wall 441; *Gesellschaft fur Drahtlose Telegraphie M. B. H.* v. *Brown*, 78 F. (2d) 410 (D. C. Cir.); *Hazelton* v. *Sheckells*, 202 U. S. 71. However, these decisions do not produce a blanket condemnation of all lobbying and legislative activities. Rather, they find an evil in *contingent fee arrangements to accomplish particular legislative ends through "private" bills.* This kind of lobbying, essentially the operation of "five percenters", may truly tend to corrupt the legislative process. This Court long ago pointed out, "Where the avarice of the agent is inflamed by the hope of a reward contingent upon success, and to be graduated by a percentage upon the amount appropriated, the danger of tampering in its worst form is greatly increased." *Trist* v. *Child*, 21 Wall 441, at p. 452. In another case it pointed out, "In its inception the offer, however intended, necessarily invited and tended to induce improper soliciting, and it *intensified the inducement by the contingency of the reward*". *Hazelton* v. *Sheckells*, 202 U. S. 71, at p. 79 (italics added).

The *Textile Mills* case involved this type of lobbying activity. The arrangements in that case called for a contingent fee for services to secure the passage of a special bill releasing particular properties held by the Alien Property Custodian. The *Textile Mills* decision by no means stands for the proposition that all legislative activity in any form offends against the public interest and welfare. In the *Lilly* case, this Court indicated that the *Textile Mills* decision rested upon the fact that "*some* types of lobbying expenditures had long been condemned" (italics added). See *Lilly* v. *Commissioner*, 343 U. S. 90, 95.

It seems obvious that the legislative activities of the NTEA, intended to create a public opinion favorable to changes in the Internal Revenue Code and consisting otherwise of open appearances before the Congressional committees on taxation, in no way frustrated sharply defined public policies. These activities were far removed from contingent fee arrangements for obtaining *ad hoc*

laws favoring a particular individual. To the contrary, the legislative activities of the NTEA fall within the framework of very ordinary conduct carried on by business and labor organizations generally. To say that any appearances before Congressional committees defeat public policy is to maintain, tacitly, that the Congressional hearings themselves offend against the public interest.

Summing up this point of the petition, the decision of the Court of Appeals necessarily rests on public policy grounds. In view of the uncontroverted findings of the same Court with respect to NTEA's actual conduct, there is no basis for a determination that the conduct of the petitioner or the NTEA is of an outlawed species "to which the law gives no sanction". The decision below is fundamentally in conflict with *Lilly* v. *Commissioner, supra; Rumely* v. *United States, supra; Lucas* v. *Wofford, supra;* and *Leubuscher* v. *Commissioner, supra.* It also constitutes an unwarranted and erroneous extension of the *Textile Mills* decision to a totally different factual situation. This conflict involves an important question of law which this Court should resolve.

II. Amendments to the Regulation Applied in Textile Mills Necessitate a Review of the Rule of that Case.

As previously indicated, the *Textile Mills* decision turned on Treasury Regulation 74, Article 262, promulgated under the Revenue Act of 1928.[3] What has been overlooked completely by the Court below are the important changes in the applicable law and regulations since the taxable years involved in that case.

Without the support of a specific statute or regulation there is no warrant for disallowance of the deduction of any ordinary and necessary business expense except where public policy may be frustrated.

[3] See *Lilly* v. *Commissioner*, 343 U. S. 90: "In *Textile Mills Corp.* v. *Commissioner*, 314 U. S. 326, this Court accepted an interpretation of that section [Section 23(a)(1)(A)] by a Treasury Regulation which disallowed the deduction of certain expenditures for lobbying purposes."

Treasury Regulation 74, Article 262 was a double purpose regulation. It covered *both* contributions to charitable organizations and non-charitable organizations and was construed to apply to deductions under both Section 23(n) and Section 23(a) of the Revenue Act of 1928. "Sums of money expended for lobbying purposes" were not deductible under that regulation regardless of which of the two sections the deduction was claimed under. Pursuant to certain statutory changes described below, Article 262 has now been split, between two provisions of the regulations—Regulation 111, Section 29.23(a)-13 and Section 29.23(q)-1. The prohibition against the deduction of lobbying expenses is now included only in Section 29.23(q)-1, and it is no longer applicable to questions arising under Section 23(a).

In discussing this contention the Court below declared it "clearly untenable" under the *Textile Mills* decision. This answer misses the point. The contention is directed at the state of the law pursuant to changes in the law and regulations *after* the taxable years involved in *Textile Mills*, and nothing said in *Textile Mills* could possibly have any bearing on the construction of a later-enacted statute and a later-promulgated regulation. In Section 102(c) of the Revenue Act of 1935, now Section 23(q)(2), it was provided for the first time that corporations as well as individuals could deduct contributions made to organizations organized exclusively for charitable, scientific, educational or similar purposes, with the exception of such organizations, a substantial portion of whose activites consisted of carrying on propaganda or attempting to influence legislation.

In the Revenue Act of 1938, Section 23(a) was amended to include a new Section 23(a)(2) (now Section 23(a)(1)(B):

> "(2) CORPORATE CHARITABLE CONTRIBUTIONS. No deductions shall be allowable under paragraph (1) to

a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained * * *."

In the report of a Subcommittee of the House Ways and Means Committee this new provision was explained as follows:

"In 1935 the income-tax law was amended to provide a specific deduction for charitable and other contributions by corporations to an amount not exceeding 5 percent of the corporate net income. No similar provision appeared in the law in prior years; but with respect to such years the Board of Tax Appeals and Federal courts held, in various cases, that particular gifts to charitable, religious, and welfare organizations were deductible as business expenses. When the specific subdivision was inserted in 1935, no change was made in the subdivision allowing deductions for business expenses, probably because the *Congress believed that the new specific provision would necessarily be controlling in respect of contributions to the designated organizations.* In order to clarify the law, the subcommittee recommends (Recommendation No. 36) that the specific subsection relating to business expenses, section 23(a), be amended to provide expressly that no deduction shall be allowed to corporations thereunder for any contribution of a class with respect to which a deduction is allowed by section 23(q)." (75th Cong., 3d Sess., H. Rept. January 14, 1938, p. 48; italics added.)

The report makes it plain that section 23(q)(2) was intended to be controlling in respect of contributions to the type of organization listed in that section. *Contributions to other organizations as ordinary and necessary business expenses are controlled by section 23(a).* As

no lobbying limitation was written into Section 23(a) it would appear that Congress did not intend that limitation to apply to organizations not described in Section 23(q)(2). The NTEA is not an organization of the type described in Section 23(q)(2), not being exclusively charitable or educational in purpose. See § 101(6), (7).

This distinction between Section 23(a) and Section 23(q) has been reflected in revised regulations for the taxable years involved in this case. The language of old Regulation 74, Article 262, has been split between Regulation 111, Section 29.23(a)-13 and Regulation 111, Section 29.23(q)-1 (reproduced in part in the Appendix). The effect of this split can be readily observed. Section 29.23(a)-13 reads in part as follows (italics indicates identical language to Regulation 74, Article 262):

> "• • • Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. *For example, a street railway corporation may donate a sum of money to an organization* (of a class not referred to in section 23(q)) *intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.*"

Regulation 111, Section 29.23(q)-1, reads in part as follows (italics indicates identical language as in Regulation 74, Article 262):

> "A corporation may, subject to the limitations provided by Section 23(q), deduct from its gross income, contributions or gifts to organizations described in section 23(q). • • • Such deduction shall, to the extent

provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, * * * *. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23(a)-13. *Sums of money expended for lobbying purposes, the promotion or defeat of legislation the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.*"

Thus, instead of a single section covering the entire field of corporate donations and disallowing all donations made for lobbying purposes, the current regulation provides for two separate and mutually exclusive sections—only one of which prohibits the deduction of lobbying expenses.

It seems perfectly clear that this "split" in the regulation drew a new distinction between donations made as an ordinary and necessary expense of the taxpayer's business and donations made to organizations described in Section 23(q). As to the latter the prior rule remains in full force and effect—a contribution to an organization engaged in lobbying cannot be deducted. But where the payment is an expense of doing business and is not made to an organization described in Section 23(q), *there is no applicable Treasury regulation disallowing the deduction of such an expenditure merely on the grounds that it was expended for lobbying purposes.*

Obviously since Congress has acquiesced in this change in the regulations since 1938, it is the legislative intent that the provision prohibiting the deduction of lobbying expenses, while applying in the case of contributions to certain exempt charitable, educational and scientific organizations, does not apply to legitimate business expenses.

Therefore, as the deductibility of this class of ordinary and necessary expenditure is no longer specifically prohibited by regulation when claimed under Section 23(a)

(1)(A), it need only be shown that it is consistent with public policy as that term has been defined for tax purposes in the *Lilly* case.

The petitioner's conduct, even if held to be the equivalent of lobbying, which it was not, was honorable and without any taint of illegality or moral wrongdoing. There is abundant authority for the allowance of deductions even where both flagrant illegality and immorality are the cause of the expenditure. *Commissioner* v. *Heininger, supra; Helvering* v. *Hampton*, 79 F. (2d) 358. This Court should not sanction the purely arbitrary and unfair discrimination of the respondent against the class of expenditures involved in this case. With the amendment of the specific regulation which provided the basis of decision in the *Textile Mills* case, the last obstacle to the abolition of an anachronistic rule has been removed. No sensible argument exists for its perpetuation. Properly carried on, legislative representation of businessmen is a necessary and desirable activity in this day of ever-increasing contact between government and business. This petitioner does not present the case for the briber, the influence peddler and their ilk. Since the *Textile Mills* decision the Congress which is properly most concerned with the lobbying problem has passed effective legislation to control and regulate it. In the Federal Regulation of Lobbying Act (2 U. S. C. A. §§ 261-270) enacted August 2, 1946 the Congress provided for the registration of lobbyists. The Report to the Senate of the "Special Committee on the Organization of Congress" on this Act describes the various types of lobbyists to which the registration requirement applies:

> "There is a third class of * * * respectable representatives of business, professional and philanthropic organizations who come to Washington openly and frankly to express their views for or against

> legislation, many of whom serve a useful and perfectly legitimate purpose in expressing the views and interpretation of their employers with respect to legislation which concerns them * * *." (S. Rept. 1400, 79th Cong., 2d Sess., p. 27.)

A spokesman for the Committee presenting the bill on the floor of the House stated:

> "After all, government having moved so deeply into the whole business, economic, and social field that the many fine organizations which represent various economic interests would be almost remiss in their obligation if they failed to keep abreast of developments in the legislative field." (Cong. Rec., Vol. 92, Part 8, p. 10090.)

It can hardly be said that such activity belongs to the "family of contracts to which the law has given no sanction". The very requirement of registration implies not only sanction, but conditional approval.

The decision of this Court in the *Lilly* case provides a clear and workable test for the disallowance of expenditures, which although made in the ordinary course of business, are made for a purpose so repugnant to a federal or state policy that in good conscience they should not be deductible. It is submitted that this is the rule that would have been adopted by this Court in the *Textile Mills* case but for the existing regulation.

Accordingly, stripped of the specific regulation governing the *Textile Mills* case, and without compensating support from the amended regulation or the statute, the respondent can only rely on the "public policy" doctrine to sustain his current position and that doctrine, as delineated in the *Lilly* case, gives no support to the respondent's position.

III. The Decision of the Court of Appeals Involves a Fundamental Misconstruction of Section 23(a)(1)(A) of the Internal Revenue Code.

The Courts below have made a fundamental error in construction of the applicable statute, Section 23(a)(1)(A) of the Internal Revenue Code. On the evidence they found that the NTEA was engaged in lobbying activities but they were unable to make a similar finding with respect to the petitioner. On the basis of such a record the findings of the Tax Court do not even make out a *prima facie* case for the disallowance of the petitioner's claimed deduction under Section 23(a)(1)(A). The standard of deductibility set up by that section is plain—the expenses in question must be an ordinary and necessary business expense of the taxpayer claiming the deduction and incurred during the taxable year.

The taxpayer is entitled to have its deduction determined on the basis of its own acts, purposes and objectives and not on the basis of the acts, purposes or objectives of the recipient of the payment, particularly in the absence of a finding or any evidence that would impute the recipient's purposes to the petitioner. The Courts below failed to note this missing link in the evidence. Conceding *arguendo*, that all lobbying expenses are non-deductible and similarly conceding that the NTEA was engaged in lobbying, it does not follow as the conclusion to the syllogism that the petitioner's payment to NTEA is non-deductible. What is obviously lacking is a finding as to the purposes of the petitioner in making the contribution.

The gap is not to be sloughed over. Where subjective intent is an operative fact the Courts have refused to attribute the purposes of one taxable entity to another even where the relationship of parent and subsidiary exists between them. *Mead* v. *Commissioner*, 116 F. (2d) 187 (3rd Cir.); *Rodman Wanamaker Trust*, 11 T. C. 365, aff'd 178 F. (2d) 10.

This point is not addressed to a mere technical defect in the findings. The petitioner offered a good deal of evidence as to its purposes which the Tax Court did not include in its findings, and neither the Tax Court nor the Fourth Circuit considered it in their opinions. This evidence may be briefly summarized. The petitioner's President testified that its strongest competitor was a co-op, the Farmers Co-Operative Exchange (R. 2). The co-op undersold the petitioner (R. 3) and the petitioner regarded the co-op as a serious threat to its business (R. 4). The petitioner received pamphlets and books from the NTEA with a good deal of statistical and factual information about co-ops which petitioner used to advise and inform the retailers to whom it sold about the nature and extent of the co-op threat (R. 6). Petitioner received no material from NTEA urging any action to influence legislation (R. 7). To the best of petitioner's knowledge NTEA did not have a lobby in Washington during the taxable years involved (R. 10). Nobody in the petitioner's organization contacted the Congressmen or Senators from North Carolina in connection with tax legislation (R. 11-12). The NTEA put the petitioner in a position to explain to its customers the nature of the cooperative movement and its dangers (R. 8).

In short, to maintain its business the petitioner felt it necessary to get the facts about the co-operative movement and to marshall the arguments which would stem the alarming drift of its customers to the co-operative fold. The NTEA supplied this need.

The Courts below have placed the wrong entity on trial. While the NTEA's activities might well be conclusive of the question if a charitable deduction had been claimed under Section 23(q)(2),[4] they are far from conclusive when the deduction is claimed under Section 23(a)(1)(A).

[4] This case does not arise under Section 23(q)(2) where the statute clearly provides that corporations may deduct only such charitable contributions as are made to organizations which meet the qualifications set forth in that section.

The petitioner and the NTEA are two wholly separate entities for tax purposes.

IV. The Textile Mills Decision Should be Modified.

In the event this Court should decide that the *Textile Mills* decision is applicable to the petitioner's contribution, it is earnestly urged that consideration be given to a modification of the doctrine laid down in that case. Since the taxable year involved in *Textile Mills* federal and state governments have embarked on prodigious programs of regulation and taxation of business activity. The federal government, particularly, has moved deeply into virtually all fields of business activity. In enacting legislation of this kind the Congress must necessarily seek the advice and opinion of the members of the group to be affected. These groups must be alert to present their views in a forceful but legitimate manner. The prosperity and welfare of all business is now, more than ever, dependent on an ability to "live" with such regulation and taxation as may be adopted. It is manifestly unfair to restrict their legitimate activities in proposing or opposing legislation by denying to them a deduction for their expenses incurred thereby. That Congress believes that there is a real function for the legitimate lobbyist to perform is amply demonstrated by the legislative history of the Federal Regulation of Lobbying Act, previously discussed.

It is suggested that this Court modify the holding in the *Textile Mills* case to apply only to expenses incurred pursuant to lobbying arrangements which were condemned at common law. *Trist* v. *Child, supra; Hazelton* v. *Scheckells, supra.* The public interest will be adequately protected by a rule which permits the deduction of expenses incurred in legitimate educational, publicity and legislative activity.

Presentations of arguments to legislative bodies in a "public and legitimate" manner should not be the subject of special unfavorable tax treatment. *Lucas* v. *Wofford, supra.* The right of the people freely to communicate with and legitimately influence their elected representatives without penalty or impediment is a primary issue in this case. *Cf. Rumely* v. *U. S., supra.* The rule in this area as presently applied by the respondent, indiscriminately penalizes all varieties of legislative activity, whether or not such activity frustrates public policy or would tend to corrupt. This rule is inconsistent with the general doctrine set out in *Lilly* v. *Commissioner, supra.* This Court should conform the special rule of *Textile Mills* to the principle enunciated in the *Lilly* case.

Conclusion

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

JOSEPH J. O'CONNELL, JR.,
Counsel for Petitioner.

APPENDIX "A"

Treasury Regulation 74, Article 262:

"Corporations are not entitled to deduct from gross income contributions or gifts which individuals may deduct under section 23(n). Donations made by a corporation for purposes connected with the operation of its business, however, when limited to charitable institutions, hospitals, or educational institutions conducted for the benefit of its employees or their dependents are a proper deduction as ordinary and necessary expenses. Donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income. For example, a street railway corporation may donate a sum of money to an organization intending to hold a convention in the city in which it operates, with the reasonable expectation that the holding of such convention will augment its income through a greater number of people using the cars. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertisting other than trade advertising, and contributions for campaign expenses, are not deductible from gross income."

Treasury Regulation 111, Section 29.23(a)-13:

"Corporate contributions.—No deduction is allowable under section 23(a) for a contribution or gift by a corporation if any part thereof is deductible under section 23(q). Thus, for example, if a corporation makes a contribution of $5,000, only $4,000 of which is deductible under section 23(q) (whether because of the 5 per cent limitation or requirement of actual payment, or both), no deduction is allowable under section 23(a) for the remaining $1,000.

"The limitations provided in section 23(a)(1) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 23(q). For example, payments by a street railway corporation to a local hospital (which is a charitable organization within the meaning of section 23(q)) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the corporation's employees are not contributions or gifts within the meaning of section 23(q) and may be deductible under section 23(a) if the requirements of that section are otherwise satisfied. Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway corporation may donate a sum of money to an organization (of a class not referred to in section 23(q) intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars."

Treasury Regulation 111, Section 29.23(q)-1:

"Contributions or gifts by corporations.—A corporation may, subject to the limitations provided by section 23(q), deduct from its gross income contributions or gifts to organizations described in section 23(q), except in computing net income for taxable years beginning before January 1, 1944, contributions or gifts to organizations organized and operated exclusively for veterans' rehabilitation services, or posts or organizations of war veterans, or auxiliary units of, or trusts or foundations for, any such posts or

organizations are not deductible unless such contributions qualify as deductions under section 23(q) prior to its amendment by section 114 of the Revenue Act of 1943. See section 29.22(b)(4)-1 for definition of 'political subdivision'. Where payment is made in a taxable year beginning before January 1, 1949, the charitable deduction prescribed is allowable to corporations even though the gifts or contributions are used outside of the United States or its possessions. Such deduction shall, to the extent provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, regardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23(a)-13. Sums of money expended for lobbying purposes, the promotion or defeat of leglislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income. * * *"

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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 75

AMERICAN HARDWARE & EQUIPMENT CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 22-24) are not officially reported. The opinion of the Court of Appeals (R. 72-79) is reported at 202 F. 2d 126.

JURISDICTION

The judgment of the Court of Appeals (R. 79) was entered on February 17, 1953. The petition for a writ of certiorari was filed on May 18, 1953. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether the Court of Appeals correctly affirmed the decision of the Tax Court that the $1,800 and $1,500 payments made by the taxpayer to the National Tax Equality Association were not deductible from gross income as ordinary and necessary business expenses under Section 23(a)(1)(A) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code and of Treasury Regulations 111 are set forth in the Appendix, *infra,* pp. 10-14.

STATEMENT

Petitioner taxpayer, American Hardware & Equipment Company, sought a redetermination of income tax deficiencies determined against it by the Commissioner for its fiscal years ended June 30, 1947 and 1948. The only issue presented to the Tax Court for decision was whether the sums of $1,800 and $1,500 paid by the taxpayer to the National Tax Equality Association (hereinafter referred to as "NTEA") in those years, respectively, were deductible from its gross income, either under Section 23(a)(1)(A) or Section 23(q)(2) of the Internal Revenue Code. (R. 22.)

The facts found[1] by the Tax Court (R. 22-23) may be summarized as follows:

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[1] The findings were made upon the basis of oral testimony—some of which (R. 1-20) was reproduced in an Appendix to the brief for the taxpayer in the court below, while additional

The taxpayer has been engaged since its incorporation in 1917 in the wholesale hardware business in the states of North Carolina and South Carolina. Prior to and during the taxable years, it was faced with competition from other distributors, one of which was the Farmer's Cooperative Exchange. (R. 22.)

NTEA is a non-profit corporation organized under the laws of Illinois in October, 1943. Its articles of incorporation provide that the objects and purposes for which it was organized are (R. 23):

> * * * to conduct educational, scientific and research activities relative to disparities in federal and state tax statutes and other laws and regulations affecting business, and to disseminate such information to civic organizations and representatives of business affected thereby, to the public and to federal and state governments. The Corporation shall be non-sectarian, non-partisan, and no part of the net earnings, if any, of the Corporation shall inure to the benefit of any private shareholder or individual.

NTEA was first ruled exempt from taxation under Section 101(6), but at its request was later ruled

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portions were reproduced in an Appendix to the brief for the Commissioner (R. 34-46)—and numerous exhibits adduced in evidence by both sides. Because all the exhibits had been ordered transmitted to the court below in their original form, and to avoid any possible confusion in identifying the various exhibits, the Commissioner prepared and printed, as a separate appendix to his brief in the court below, a complete list (R. 47-60) and a brief description of all of the exhibits in the case and of the principal parts thereof, and quoted certain excerpts therefrom.

exempt as a business league under Section 101(7) of the Internal Revenue Code. (R. 23.)

NTEA was organized and primarily operated from its inception, and during the taxable years in question, for the carrying on of propaganda, the ultimate objective being a revision in the tax structure. (R. 23.)

The suggestion that the taxpayer make contributions to the NTEA came from the taxpayer's president, L. D. Nuchols, who was elected a director of NTEA for the years 1947 and 1948 but did not attend any of the directors' meetings. The taxpayers' directors did not adopt any resolution authorizing the contributions made by the taxpayer to NTEA but informally approved the suggestion of its president. (R. 23.)

In its tax returns for the two years in question, the taxpayer claimed as deductions the amounts of $1,800 and $1,500, representing contributions made by it to NTEA. The Commissioner disallowed them on the ground that they did not constitute proper deductions. (R. 22-23.)

After making the foregoing findings of fact, the Tax Court stated (R. 24) that it had recently passed upon the identical question in *Roberts Dairy Co.* v. *Commissioner,* decided October 31, 1950 (1950 P-H T. C. Memorandum Decisions, par. 50,271),[2] and that it regarded that case as controlling. The Tax Court therefore held that the amounts of $1,800 and $1,500 paid by taxpayer to NTEA did not constitute proper deductions under either Sec-

[2] Affirmed, *Roberts Dairy Co.* v. *Commissioner,* 195 F. 2d 948 (C.A. 8th), certiorari denied, 344 U.S. 865.

tion 23(a)(1)(A) or 23(q)(2) of the Code (R. 24). The Court of Appeals for the Fourth Circuit affirmed (R. 72-79).

ARGUMENT

The decision below is clearly correct and, substantially, the petition presents no question which was not before this Court in *Roberts Dairy Co.* v. *Commissioner,* No. 319, 1952 Term, certiorari denied, 344 U.S. 865.

1. Section 29.23(q)-1 of Treasury Regulations 111 (Appendix, p. 14, *infra*) provides that—

> Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.

In *Textile Mills Corp.* v. *Commissioner,* 314 U.S. 326, an identical provision of an earlier regulation, of long standing, was upheld by this Court, and held applicable to deductions for expenditures claimed under Section 23(a) of the Code (Appendix, p. 10, *infra*) as ordinary and necessary business expenses.

As the court below properly recognized (R. 77-78), the *Textile Mills* decision is clearly controlling here. The Tax Court found (R. 23) that NTEA was organized and operated for the carrying on of propaganda, seeking a revision of the tax laws. The court below, upon the record, upheld (R. 76-77) that finding as "abundantly supported by the evidence." Accordingly, the court below was ob-

viously correct in sustaining the disallowance of the deductions sought as ordinary and necessary expenses under Section 23(a),[3] "since they clearly run afoul of the prohibition * * * of the regulation". *Textile Mills, supra,* p. 337.

2. In substance, the reasons for the granting of the writ urged here are identical to those which were advanced in the petition in *Roberts Dairy Co.* v. *Commissioner,* 195 F. 2d 948, certiorari denied (No. 319, 1952 Term), 344 U.S. 865. In that case the Court of Appeals for the Eighth Circuit had similarly upheld the denial of a deduction of a payment to the very same organization, NTEA.

a. The first reason urged here (Pet. 6-14; cf. *Roberts Dairy* petition, *passim*), to the effect that the decision below is inconsistent with *Textile Mills, supra,* and *Lilly* v. *Commissioner,* 343 U.S. 90, rests upon the contentions: (i) that *Textile Mills* constitutes no more than the approval of the disallowance of a deduction for sums expended for lobbying purposes by a taxpayer in the lobbying business; and (ii) that to be non-deductible under Section 23(a)(1)(A) an expenditure must have been for something sinister, illegal or deeply repugnant to public policy. Neither of the arguments has any merit. As to the first, it seems clear that no such narrow reading of *Textile Mills* is warranted, but even if it were there would be no basis for the

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[3] The taxpayer (cf. R. 24, 73) also sought deductions for the same item as contributions under Section 23(q)(2) of the Code (Appendix, pp. 11-12 *infra*)—which expressly denies deductibility where a "substantial part of the activities" of the donee is "carrying on propaganda, or otherwise attempting, to influence legislation." That contention is abandoned here.

assertion of any inconsistency or conflict with the decision below, inasmuch as both decisions affirmed the disallowance of deductions for this type of expenditure. As to the second, the decision in the instant case, like this Court's decision in *Textile Mills,* rests upon an interpretative regulation which "had itself been in effect many years with congressional acquiescence." *Lilly, supra,* at 95. As there was no such interpretative regulation in *Lilly,* that case did not come "within [the] precedent [of *Textile Mills*]." (*Ibid.*) The same regulation here, still retaining the acquiescence of Congress, has necessarily led to a result similar to that in *Textile Mills.* Indeed, the plain terms of the Regulation have never been limited to preventing only deductions of expenditures for illegal or shady purposes, and nothing in the *Lilly* case, or anywhere else, reveals any reason why they should be so limited now. See *Bellingrath* v. *Commissioner,* 46 B.T.A. 89; cf. *Sunset Scavenger Co.* v. *Commissioner,* 31 B.T.A. 758, 763, reversed, 84 F. 2d 453 (C.A. 9).

b. The second reason advanced by this taxpayer (Pet. 14-20; cf. *Roberts Dairy* Petition, pp. 14-18) is that changes in the applicable statutes and regulations since the *Textile Mills* decision require a different result now. The argument, briefly stated, runs as follows: Subsequent to the taxable years involved in *Textile Mills,* Congress, in what is now Section 23(q)(2) of the Code (Appendix, pp. 11-12, *infra*), made a specific provision for the deduction of charitable contributions by corporations. The old regulation (i.e., the one involved in *Textile Mills*) was divided in two, leaving the relevant por-

tion (Section 29.23(q)-1 of Regulation 111) applicable only—so it is claimed—to deductions sought for charitable contributions under Section 23(q)(2) of the Code. The contention is, in other words, that, as a result of these changes, deductions for expenditures for the promotion of legislation, propaganda, lobbying, etc., sought under Section 23(a)(1)(A) of the Code as business expenses, are no longer specifically prohibited by regulation. This, plainly, is only a repetition of an argument made in *Textile Mills,* which this Court rejected squarely, stating, with reference to the identical provision contained in the old regulation, that the "argument that it was not applicable because it was not specifically incorporated under § 23(a) is frivolous." 314 U.S. at 338. The provision in question, now contained in Section 29.23(q)-1 of the Regulations, is phrased generally, and says that sums like those here in dispute "are not deductible from gross income." The failure to repeat that restriction in a separate section of the Regulations attached to every separate subsection of the Code under which such a deduction might be claimed is of no more weight here than it was in *Textile Mills.*

c. The third reason urged here (Pet. 21-23; cf. *Roberts Dairy* Petition, pp. 10-12) is that the deductibility of expenditures under Section 23(a) should be tested only upon the basis of the purposes and objectives of the taxpayer making the expenditure and seeking the deduction, without regard to the activities or purposes of the donee of the contribution or of the recipient of the particular expenditure. The Tax Court found in this case that

NTEA was organized and operated for the carrying on of propaganda seeking a revision of the tax laws, and that finding was upheld by the court below. The attempt to evade the consequences of that finding by urging that the private purposes of the taxpayer were different from those of the organization to which it gave its funds cannot alter or obscure the fact that, within the prohibition of the provision of the Regulations in question, the funds were "expended for * * * the promotion * * * of legislation * * * [and] the exploitation of propaganda * * *."

3. The only notable variation, insofar as substance is concerned, between the petition in this case and that in *Roberts Dairy* is that in the instant case it is urged as a separate reason (Pet. 23-24) that the *Textile Mills* decision should be modified. There is no merit to this contention, and, there having been no intervening statutory changes of significance, there is presented no valid reason for a re-interpretation of the identical provision of the Regulations today.

Respectfully submitted,

OSCAR H. DAVIS,
Acting Solicitor General.

H. BRIAN HOLLAND,
Assistant Attorney General.

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HARRY MARSELLI,
Special Assistants to the Attorney General.

JULY, 1953.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(B) *Corporate Charitable Contributions.*—No deduction shall be allowable under subparagraph (A) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained and for the

requirement therein that payment must be made within the taxable year.

* * * * *

(q) [as amended by Section 125 of the Revenue Act of 1942, *supra,* and by Section 114 of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Charitable and Other Contributions by Corporations.*—In the case of a corporation, contributions of gifts payment of which is made within the taxable year to or for the use of:

* * * * *

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States, or of any State or Territory, or of the District of Columbia, or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, veteran rehabilitation service, literary, or educational purposes or for the prevention of cruelty to children (but in the case of contributions or gifts to a trust, chest, fund, or foundation, payment of which is made within a taxable year beginning after the date of the cessation of hostilities in the present war, as proclaimed by the President, only if such contributions or gifts are to be used within the United States or any of its possessions exclusively for such purposes), no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the ac-

tivities of which is carrying on propaganda, or otherwise attempting, to influence legislation; or

* * * * *

to an amount which does not exceed 5 per centum of the taxpayer's net income as computed without the benefits of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(a)-13. *Corporate Contributions.* —No deduction is allowable under section 23 (a) for a contribution or gift by a corporation if any part thereof is deductible under section 23(q). Thus, for example, if a corporation makes a contribution of $5,000, only $4,000 of which is deductible under section 23(q) (whether because of the 5 percent limitation or requirement of actual payment, or both), no deduction is allowable under section 23(a) for the remaining $1,000.

The limitations provided in section 23(a) (1) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 23(q). For example, payments by a street railway corporation to a local hospital (which is a charitable

organization within the meaning of section 23(q) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the corporation's employees are not contributions or gifts within the meaning of section 23(q) and may be deductible under section 23(a) if the requirements of that section are otherwise satisfied. Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway corporation may donate a sum of money to an organization (of a class not referred to in section 23(q)) intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.

* * * * *

SEC. 29.23(q)-1. *Contributions or Gifts by Corporations.*—A corporation may deduct from its gross income contributions or gifts to organizations described in section 23(q) (see section 29.22(b)(4)-1 for definition of "political subdivision"). * * * Such deduction shall, to the extent provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, re-

gardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23(a)-13. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.

* * * * *

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 75

AMERICAN HARDWARE AND EQUIPMENT COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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REPLY BRIEF FOR THE PETITIONER

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The respondent's brief in opposition makes certain erroneous and confusing statements upon which we would like to comment.

1. The respondent quotes a section of Treasury Regulations 111, section 29.23(q)-1, pertinent to section *23(q)* of the Code, as the provision controlling the question of payments claimed as deductions under section *23(a)*. He then asserts that an "identical provision of an earlier regulation" has been upheld by this Court in *Textile Mills Securi-*

ties Corporation v. *Commissioner*, 314 U. S. 326. In fact, as the petitioner's principal brief[1] has demonstrated, the quoted part of the earlier regulation was, after the *Textile Mills* decision, made applicable exclusively to section 23(q) of the Code.

2. The respondent argues that the effect of statutory changes and corresponding revisions of the Treasury Regulations, made *after* the decision in the *Textile Mills* case, was considered and discussed in the opinion of the Court *in that case*. We need not dwell on why that is not and could not be the fact. This Court, in its decision in the *Textile Mills* case, did not attempt to predict the course of *future* legislation and Treasury interpretations thereof, and did not attempt to decide prospective cases under such prospective laws.

3. Observing that this Court denied a writ of certiorari upon petition of the taxpayer in *Roberts Dairy Co.* v. *Commissioner*, 195 F. 2d 948, certiorari denied, 344 U. S. 865, the respondent seems to assume, and urge, that the denial of the writ in the *Roberts Dairy* case is *stare decisis* and disposes of this petition. While the underlying issue in that case and the instant case is the same, the present record is more adequate and complete, and the arguments presented here are, we believe, more fully developed. Furthermore, the legal status of lobbying activities has been and is being reconsidered by the courts, including this Court, at the present time.

In any event, as this Court has declared many times, "a denial (of certiorari) carries with it no implication whatever, regarding the Court's views on the merits of a case which it has declined to review." *Maryland* v. *Baltimore Radio Show*, 338 U. S. 912, 919. "Matters relevant to the exercise of our certiorari discretion frequently result in denials of the writ without any consideration of the merits." *Wade* v. *Mayo*, 334 U. S. 672, 680.

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[1] Pet. Br., pp. 14-21.

4. In the absence of any provision in section 23(a) of the Code barring deductions for expenditures incurred for lobbying or legislative activities, it is very evident that a disallowance necessarily and ultimately rests upon "public policy" grounds. *Cf. Lilly* v. *Commissioner*, 343 U. S. 90. This is true whether or not Treasury Regulations purport to bar expenditures for lobbying or legislative activities which otherwise constitute ordinary and necessary trade or business expenses. A regulation which does not rest upon statutory language must logically depend upon considerations of policy, and the validity of its application must be examined in the light of such policy. The public policy basis of disallowance is simply more apparent in the absence of pertinent regulations, which we believe is the situation in the instant case.

Recent decisions of the Federal courts have made it plain that not only is legislative activity of the kind involved in the instant case legitimate and respectable, but also Congress may not infringe upon or restrain directly or indirectly the exercise of lobbying and legislative functions. *See U. S.* v. *Harris*, 109 F. Supp. 641; *National Association of Manufacturers* v. *McGrath*, 103 F. Supp. 510. *Cf. Rumely* v. *U. S.*, 197 F. 2d 166, affirmed 73 Sup. Ct. 543. The *Harris* decision, which holds the Federal Regulation of Lobbying Act unconstitutional because it violates rights of free speech and petition guaranteed by the First Amendment, is pending before this Court at the present time. Probable jurisdiction in the *Harris* case was noted by this Court on May 4, 1953, and the case, docketed as No. 32,[2] has been set down for argument on October 19, 1953.

If legislative and lobbying activities are so far protected by law that Congress may not substantially control and regulate their exercise, it seems to us wholly unrealistic to argue that these same activities frustrate sharply defined public policy. On the other hand, if these activities are

[2] This case was docketed as No. 700 for the October Term, 1952.

recognized as legitimate and proper, the underlying basis for denying a deduction falls away entirely.

5. In view of the widespread character and impact of legislative activities in present day society, the importance of the deduction issue presented in the instant case can hardly be overstated in terms of the overall dollar amounts and number of taxpayers involved. The decisions below present a challenge to the propriety of any payment made by any individual or company to any organization, if the organization, with or without the knowledge of the contributor, appears before Congressional committees or publicizes its point of view on legislative matters. These decisions thus put in question the deductibility of contributions or fees to numerous civic organizations, chambers of commerce, business leagues and federations, and trade unions, to mention only some of the organizations and persons affected.

Conclusion

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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